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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**IBA Report Number:** 09-50

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# Fiscal Year 2010 Tax and Revenue Anticipation Notes (TRANs)

## OVERVIEW

The City Council is being asked to approve a resolution authorizing the issuance of the Fiscal Year 2010 Tax and Revenue Anticipation Notes (FY 2010 TRANs) in an amount not to exceed \$140 million. Additionally, the resolution would authorize Underwriter Services, Bond and Disclosure Counsel Services, and other necessary costs of issuance. The IBA has reviewed the proposed FY 2010 TRANs borrowing with the City's financing team including Debt Management and Comptroller staff. This report comments on key elements of the proposed FY 2010 TRANs financing.

## FISCAL/POLICY DISCUSSION

### FY 2010 TRANs Overview

As noted in Report to the City Council #09-079 (Staff Report), TRANs address temporary cash flow shortfalls arising from fluctuations in annual tax or revenue receipts that the General Fund is dependent on to meet monthly cash flow needs during the fiscal year. The City traditionally issues TRANs at the beginning of a fiscal year in order to avoid cash deficits prior to the receipt of significant revenues each year (primarily property tax revenues received from the County beginning in December and April). The amount of a TRANs borrowing should closely match the maximum projected cash deficit for the fiscal year so as to minimize borrowing costs and adhere to IRS guidelines for sizing a TRANs issuance.

The California Government Code and City Charter Section 92 allow for the issuance of TRANs. City Charter Section 92 limits the aggregate amount of the TRANs Borrowing to 25% of the City's total budgeted appropriations in a fiscal year (approximately \$282 million in FY 2010). This requirement is satisfied as the request is to authorize not more than \$140 million of TRANs which is well below the \$282 million limit.

Internal Revenue Service regulations further require that the General Fund cash flow deficit be at least 90% of the TRAN borrowing amount (meaning the cash deficit had to be at least \$117.9 million of the \$131 million TRANs borrowing currently projected). As illustrated in Attachment 1 to the Staff Report, the General Fund is projected to reach its low cash flow point in November 2009 (approximately \$3.8 million Ending Balance) when TRANs proceeds of \$131 million are added in July 2009. So the maximum General Fund cash flow deficit (without infusing \$131 million of TRANs proceeds in July) is currently projected to be \$127.2 million (the difference between \$131 million and the \$3.8 million Ending Balance in November 2009). This indicates that the IRS requirement will be satisfied. The City would only seek to borrow more than \$131 million (not to exceed \$140 million) if the projected cash flow deficit were to increase which would also satisfy the IRS requirement.

#### Benefits Associated with the Issuance of TRANs

As mentioned above, TRANs provide a source of funds for municipalities to address temporary cash flow shortfalls. In FY 2010, TRANs proceeds will enable the City to pay the retirement ARC payment at the beginning of the fiscal year rather than on a bi-weekly basis over the course of the year. As noted in the Staff Report, this will save the City approximately \$4.8 million (\$3.6 million for the General Fund).

Depending on the interest rate environment, City revenues that are required to be set aside to pay off the TRANs can often be reinvested (until payment on the TRANs is due) at interest rates higher than those paid on the notes, thereby earning net interest income for the City. The City Treasurer has determined that net interest earnings will not be possible in FY 2010 given current market conditions and that the City would be best served to repay the FY 2010 TRANs as soon as funds are available.

#### Structure of the FY 2010 TRANs

The FY 2010 TRANs have been structured in three series of notes, each with a different amount and maturity date (December 31, 2009, January 29, 2010, and April 30, 2010). The maturity dates have been selected to repay the TRANs as soon as possible to minimize interest expense. As depicted in Attachment 1 to the Staff Report, most of the first installments of property taxes are received by the City on or before December 31, 2009. The remaining property taxes from the first installment, along with VLF and Triple Flip revenue, will be received by January 29, 2010. Most of the second installments of property taxes are received by the City on or before April 30, 2010.

The resolution before the Council authorizes the selected Underwriting Syndicate to sell the FY 2010 TRANs on a negotiated basis in accordance with the terms, conditions and procedures set forth in the Accompanying Document and the Note Purchase Agreement. The net interest rate on the FY 2010 TRANs is capped at 5%; however, the Debt Management Department estimates that the all-in net interest rate to be approximately .80% which is well below the maximum authorization

## CONCLUSION

Based on our review of the proposed borrowing with the City's financing team, the IBA recommends approval of the resolution authorizing the issuance of the FY 2010 TRANs. The FY 2010 TRANs appear to be appropriately sized and structured. TRANs proceeds will enable the City to reduce the retirement ARC payments in FY 2010 by approximately \$4.8 million (\$3.6 million for the General Fund).

The Office of the City Attorney has indicated that they will issue a due diligence and disclosure obligation memorandum this week related to the FY 2010 TRANs. This memorandum typically describes the bond financing documents and provides useful questions and answers for the City Council to consider. A certification by the Disclosure Practices Working Group should also be attached to the memorandum indicating that financial information disclosed in the FY 2010 TRANs offering documents has been reviewed by the DPWG to ensure accuracy.

The IBA has been informed that representatives of the entire financing team will be present for the City Council meeting on June 9, 2009. The IBA encourages the City Council to ask any questions they might have directly to members of the City's financing team including the City's financial advisor, bond & disclosure counsel and the underwriters. The availability of financing consultants to the City Council at or before City Council meetings where approval is sought for debt is a recommendation within the comprehensive financial training program adopted by the City Council on December 6, 2006.

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